

Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 IO-14 ISO-00 EURE-00 XMB-07 INRE-00

NSCE-00 SSO-00 USIE-00 AGR-20 CEA-02 CIAE-00 COME-00

DODE-00 EB-11 FRB-02 H-03 INR-10 INT-08 L-03 LAB-06

NSAE-00 NSC-07 PA-04 RSC-01 AID-20 CIEP-02 SS-20

STR-08 TAR-02 TRSE-00 PRS-01 SP-03 FEA-02 OMB-01

SWF-02 DRC-01 OIC-04 /201 W
----- 025967

O P 031900Z MAY 74

FM AMEMBASSY ROME

TO SECSTATE WASHDC IMMEDIATE 4624

INFO AMEMBASSY BERN PRIORITY

AMEMBASSY BONN PRIORITY

AMEMBASSY BRUSSELS PRIORITY

USMISSION EC BRUSSELS PRIORITY

AMEMBASSY COPENHAGEN PRIORITY

AMEMBASSY DUBLIN PRIORITY

USMISSION GENEVA PRIORITY

AMEMBASSY THE HAGUE

AMEMBASSY LONDON PRIORITY

AMCONSUL MILAN PRIORITY

AMCONSUL NAPLES PRIORITY

AMEMBASSY OTTAWA PRIORITY

AMEMBASSY PARIS PRIORITY

USMISSION OECD PARIS PRIORITY

AMEMBASSY STOCKHOLM

AMEMBASSY TOKYO PRIORITY

C O N F I D E N T I A L SECTION 1 OF 2 ROME 6131

E.O. 11652: GDS

TAGS: EFIN, ETRD, IT

SUBJECT: FURTHER EXPLANATION OF RATIONALE BEHIND ITALIAN IMPORT
DEPOSIT MEASURE

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PASS TREASURY AND FRB

REF: (A) ROME 5976 (NOTAL)

(B) ROME 5978 (NOTAL)

(C) STATE 090223 (NOTAL)

(D) ROME 5433

1. SUMMARY. BANK OF ITALY VICE DIRECTOR GENERAL OSSOLA ASKED EMBOFF TO VISIT BANK MAY 3 SO THAT HE COULD EXPLAIN IN GREATER DETAIL GOI RATIONALE FOR IMPOSITION OF PRIOR IMPORT DEPOSITS REPORTED IN REFS A AND B. OSSOLA WAS DISTURBED AT RATHER NEGATIVE REACTION ABROAD, PARTICULARLY BY EC PARTNERS. HE ARGUED THAT MEASURE CONFORMS TO SPECIFIC RECOMMENDATIONS OF EC MONETARY COMMITTEE AND HE THOUGHT IT WAS ALSO CONSISTENT WITH IMF STANDBY COMMITMENTS. HE ASKED WHAT ALTERNATIVE MEASURES GOI COULD HAVE ADOPTED WHICH WOULD NOT HAVE BEEN EVEN MORE UNACCEPTABLE TO INTERNATIONAL COMMUNITY. END SUMMARY.

2. OSSOLA SAID THAT IN FIRST FOUR MONTHS OF 1974 BANK OF ITALY HAD LOST \$4,000 MILLION THROUGH INTERVENTION IN EXCHANGE MARKET TO SUPPORT LIRA. IN SAME PERIOD IT HAD OBTAINED COMPENSATORY FINANCING OF \$4,135 MILLION, INCLUDING SHORT-TERM DRAWING FROM EUROPEAN MONETARY COOPERATION FUND IN MARCH. (EMBOFF DID NOT SEE DETAILED BREAKDOWN OF THESE FIGURES, BUT THEY SEEM CONSISTENT WITH DATA THROUGH MID-APRIL REPORTED IN REF B.) FACED WITH BALANCE OF PAYMENTS DRAIN OF THIS SIZE, GOI BEGAN TWO MONTHS AGO TO EXAMINE ALTERNATIVE CORRECTIVE MEASURES. INCREASE IN BANK RESERVE REQUIREMENTS AND FURTHER DEPRECIATION OF LIRA EXCHANGE RATE WERE REJECTED FOR REASONS EXPLAINED IN REF B. OTHER ALTERNATIVES, SUCH AS IMPORT QUOTAS OR IMPORT SURTAXES HAD BEEN REJECTED AS BEING EVEN MORE CLEARLY IN CONFLICT WITH ITALY'S INTERNATIONAL OBLIGATIONS AND BECAUSE THEY WOULD NOT HAVE HAD CONTRACTIONARY EFFECT ON DOMESTIC LIQUIDITY. AUTHORITIES THEN EXAMINED FOUR VARIATIONS ON PRIOR IMPORT DEPOSIT SCHEME INVOLVING EITHER 50 PER CENT PRIOR DEPOSIT OR 100 PERCENT PRIOR DEPOSIT AND

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EITHER SIX-MONTH OR 12-MONTH PERIOD FOR STERILIZATION OF DEPOSITS. GOI HAD ULTIMATELY OPTED FOR LEAST DRASTIC OF THESE FOUR VARIATIONS, I.E., 50 PER CENT DEPOSIT FOR SIX MONTHS. THIS IMPLIED DIRECT REDUCTION IN IMPORTS OF 350 BILLION LIRE AND ABSORPTION OF LIQUIDITY OF 1,980 BILLION LIRE. OTHER THREE OPTIONS WOULD HAVE HAD EFFECT OF REDUCING IMPORTS IN RANGE 700 TO 1,350 BILLION LIRE AND OF REDUCING DOMESTIC LIQUIDITY IN RANGE

2,560 TO 4,720 BILLION LIRE.

3. OSSOLA CLAIMED THAT PRIOR IMPORT DEPOSIT MEASURE HAD BEEN DELIBERATELY TAILORED TO CONFORM TO SUGGESTIONS MADE ON APRIL 5 IN EC MONETARY COMMITTEE FOLLOWING ITALIAN DRAWING UNDER EC SHORT-TERM CREDIT ARRANGEMENTS. OSSOLA GAVE EMBOFF COPY OF MONETARY COMMITTEE REPORT OF THAT MEETING, FROM WHICH ARE QUOTED FOLLOWING EXTRACTS TRANSLATED FROM ORIGINAL FRENCH TEXT:

(A) THE IMMEDIATE PROBLEM WHICH THE ITALIAN AUTHORITIES MUST FACE IS THAT OF RAPIDLY OBTAINING CONCRETE RESULTS IN THE FORM OF A NET IMPROVEMENT IN ITALY'S FOREIGN ACCOUNTS, THE CURRENT TREND OF WHICH IS UNSUSTAINABLE.

(B) AN IMPROVEMENT IN THE BALANCE OF PAYMENTS DEFICIT CANNOT OCCUR IN ANY CASE, IN THE VIEW OF THE COMMITTEE, EXCEPT BY A DETERMINED EFFORT BY THE ITALIAN AUTHORITIES TO SLOW DOWN THE EXPANSION OF DOMESTIC DEMAND.

(C) THIS IMPLIES, IN THE VIEW OF THE COMMITTEE, A FURTHER LIMITING IN THE EXPANSION OF THE MONETARY BASE ENVISAGED BY THE ITALIAN AUTHORITIES.

4. OSSOLA THOUGHT THAT MEASURES TAKEN PREVIOUS TO PRIOR IMPORT DEPOSIT, I.E., INCREASE IN BASIC DISCOUNT RATE TO 9 PER CENT AND 15 PERCENT BANK CREDIT LIMIT, HAD BEEN CONSISTENT WITH EC AND IMF RECOMMENDATIONS. PERFORMANCE WITH REGARD TO THE BUDGET INCLUDED AN ACCELERATION OF WITHHOLDING TAX ON INCOME OF INDEPENDENT WORKERS (SEE REF D). OSSOLA PERSONALLY THOUGHT THAT FURTHER TAX MEASURES WERE NEEDED, BUT THIS WAS OUTSIDE CONTROL OF BOI. OSSOLA AGAIN STRESSED THAT MEASURE WAS MAINLY AIMED AT REDUCING DOMESTIC LIQUIDITY. HE ADMITTED
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THAT IMPORT DEPOSITS WOULD ALSO IMMEDIATELY DISCOURAGE IMPORTS. HOWEVER, BOI ESTIMATES THAT EFFECT OF MEASURES WILL BE TO INCREASE COST OF IMPORTS BY ABOUT 4 PER CENT, WHICH HE THOUGHT WAS NOT A DRAMATIC DISINCENTIVE.

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STR-08 TAR-02 TRSE-00 PRS-01 SP-03 FEA-02 OMB-01

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O P 031900Z MAY 74

FM AMEMBASSY ROME

TO SECSTATE WASHDC IMMEDIATE 4625

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AMEMBASSY BONN PRIORITY

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AMEMBASSY TOKYO PRIORITY

C O N F I D E N T I A L SECTION 2 OF 2 ROME 6131

5. ITALIANS HAVE EXAMINED TREATMENT OF UK WHEN IT
INTRODUCED PRIOR IMPORT DEPOSITS IN 1968. OSSOLA
READ EXTRACT FROM IMF DOCUMENT AT THAT TIME WHICH
SEEMED TO CONCLUDE THAT PRIOR IMPORT DEPOSITS DID NOT
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CONSTITUTE RESTRICTION ON CURRENT TRANSFERS AND
PAYMENTS. HE ALSO ARGUED THAT ITALIAN MEASURES WERE
MORE CLEARLY ORIENTED TOWARD REDUCING DOMESTIC LIQUIDITY
THAN WERE UK MEASURES SINCE, IN ITALIAN CASE, DEPOSITS

MUST BE MADE AT CENTRAL BANK (RATHER THAN IN COMMERCIAL BANKS) AND DEPOSIT WILL TAKE FORM OF BLOCKED TREASURY ACCOUNT, WHICH HE SAID WAS NOT TRUE UNDER UK SYSTEM. OSSOLA RECOGNIZED THAT CURRENT ATMOSPHERE FOR INTRODUCING MEASURES OF THIS SORT WAS LESS FAVORABLE THAN IN 1968 BECAUSE OF PRESENT FEAR OF GENERALIZATION OF RESTRICTIVE MEASURES IN FACE OF OIL CRISIS.

6. OSSOLA SAID THAT ITALIAN CASE WOULD BE EXAMINED IN EC MONETARY COMMITTEE ON AFTERNOON OF MAY 6 AND IN EC COUNCIL OF FOREIGN MINISTERS ON MAY 7. HE WAS DISAPPOINTED THAT GERMANS, FRENCH AND EC COMMISSION SEEMED TO BE TAKING RATHER NEGATIVE AND ALARMIST ATTITUDE. THEY WERE STRESSING TRADE EFFECT, RATHER THAN DOMESTIC LIQUIDITY EFFECT, DESPITE GOI ATTEMPT TO TAILOR NEW MEASURE SO AS TO AFFECT DOMESTIC LIQUIDITY AND TO MINIMIZE CONFLICT WITH INTERNATIONAL OBLIGATIONS. (TREASURY MINISTRY DIRECTOR GERNERAL MICONI TOLD EMBOFF ON MAY 2 THAT HE WOULD HAVE PREFERRED MORE CLEAR-CUT MEASURE DIRECTLY AFFECTING IMPORTS, E.G., QUOTAS OR SURTAX, RATHER THAN THAT FINALLY CHOSEN.) OSSOLA SAID THAT GOI HAD PERHAPS MADE MISTAKE BY NOT PUBLICLY STRESSING TEMPORARY NATURE OF MEASURES. IT WILL DO SO NOW IN BRUSSELS IN ORDER TO REASSURE EC PARTNERS. HOWEVER, IT WOULD BE DIFFICULT FOR GOI TO ACCEPT REDUCTION IN NUMBER OF IMPORT ITEMS COVERED BY DEPOSIT REQUIREMENT, AS SOME MEMBERS OF EC COMMISSION MAY BE CONTEMPLATING. (WE UNDERSTAND THAT LIST OF IMPORTS SUBJECT TO DEPOSIT WILL BE CIRCULATED TO CUSTOMS OFFICES OVER WEEKEND AND PUBLISHED IN OFFICIAL GAZZETTE MAY 6 OR MAY 7.) OSSOLA DID NOT KNOW WHAT GOI REACTION WOULD BE TO POSSIBLE OFFER OF MEDIUM-TERM CREDIT ASSISTANCE FROM EC, ALTHOUGH AMOUNTS INVOLVED WERE RATHER SMALL COMPARED TO SIZE OF DEFICIT CONTEMPLATED FOR REMAINDER OF 1974.

7. GOI HOPED THAT ITALIAN CASE WOULD BE TREATED IN GATT IN SAME WAY AS UK CASE HAD BEEN, I.E., IT WOULD
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BE STUDIED BY WORKING GROUP WHICH WOULD RECEIVE OPINION FROM IMF ON BALANCE OF PAYMENTS JUSTIFICATION FOR MEASURE.

8. OSSOLA WAS UNHAPPY WITH PRELIMINARY REACTION OF IMF STAFF, WHO HAD TOLD ITALIANS THAT MEASURE "RUNS COUNTER TO" PARAGRAPH 9 OF LETTER OF INTENT, SO THAT STAFF WOULD EXPECT THAT ITALY WOULD NOT BE ABLE TO DRAW UNDER STANDBY CREDIT. IMF MANAGING DIRECTOR WITTEVEEN ALSO HAD COMMENTED THAT ITALY WOULD "NEED TO RENEGOTIATE" STANDBY AGREEMENT. OSSOLA SAID THAT,

IN HIS OPINION, THIS WOULD BE POLITICALLY IMPOSSIBLE
AND HE WOULD RECOMMEND TO GOI THAT STANDBY BE TERMINATED,
RATHER THAN RENEGOTIATED.

9. COMMENT: IT IS CLEAR THAT OSSOLA, AT LEAST, AND
APPARENTLY BOI AND GOI ARE DISAPPOINTED AT WHAT THEY
CONSIDER TO BE UNSYMPATHETIC REACTION TO MEASURE TAKEN
IN EXTREMIS AND WHICH THEY CLAIM WAS DESIGNED TO MINIMIZE
CONFLICT WITH INTERNATIONAL COMMITMENTS. WHILE IT IS
CLEAR THAT PRIOR IMPORT DEPOSIT WILL HAVE, AND IS
EXPECTED TO HAVE, SOME FAIRLY IMPORTANT IMMEDIATE
IMPACT ON IMPORTS, GOOD CASE CAN BE MADE THAT MEASURE
IS PRIMARILY DESIGNED TO RESTRICT DOMESTIC LIQUIDITY,
WHICH IS IN KEEPING WITH GENERAL THRUST OF BOTH IMF
STANDBY COMMITMENT AND EC MONETARY COMMITTEE RECOMMEN-
DATIONS. FOR TIME BEING, AT LEAST, GOI HAS NOT
SUCCUMBED TO TEMPTATION TO IMPOSE IMPORT QUOTAS NOR
IMPORT SURCHARGES. LATTER CANNOT BE RULED OUT EVENTUALLY,
IF BALANCE OF PAYMENTS DEFICIT IS NOT REDUCED AND
ADEQUATE FINANCING AT REASONABLE TERMS IS NOT OBTAINABLE.

10. OSSOLA SEEMED MORE CONCERNED ABOUT ATTITUDE OF EC
PARTNERS THAN ABOUT US. (EMBOFF GAVE COPY OF US PRESS
RELEASE CONTAINED IN REF C TO OSSOLA AND DELIVERED
COPIES TO MINISTRY OF TREASURY. OSSOLA THOUGHT THAT
US STATEMENT WAS MODERATE AND TOOK COGNIZANCE OF
EXTREME DIFFICULTY OF ITALIAN SITUATION. HE IMMEDIATELY
TRANSMITTED MESSAGE TO GOVERNOR CARLI, WHO HAD
ACCOMPANIED TREASURY MINISTER COLOMBO TO BRUSSELS FOR
MEETING WITH EC COMMISSION.) OSSOLA CLEARLY WISHES
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TO GET ACROSS TO US AUTHORITIES ARGUMENTS WHICH WILL
PUT ITALY IN BEST POSSIBLE LIGHT, IF AND WHEN IMF
EXECUTIVE DIRECTORS MEET TO DETERMINE WHETHER ITALIAN
ACTION HAS MADE ITALY INELIGIBLE TO DRAW ON STANDBY.
WHILE AMOUNT OF STANDBY CREDIT IS SIGNIFICANT AND
SEAL OF APPROVAL WHICH IT REPRESENTS FOR SOME PRIVATE
BORROWERS IS ALSO IMPORTANT TO ITALY, EMBASSY BELIEVES
THAT GOI MIGHT ULTIMATELY DECIDE THAT RENEGOTIATION
OF STANDBY WOULD BE POLITICALLY UNACCEPTABLE, GIVEN
INVOLVEMENT OF IMF STANDBY ISSUE IN FALL OF PREVIOUS
RUMOR GOVERNMENT. VOLPE

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